



Building Success. Together.

Developing the Credit Memo

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Goals of this Course

- Outline the basic information in a credit memo (aka loan presentation)
- The value of a standardized template/format for all types of loans
- Information required to make an appropriate credit decision
- Details needed to support the recommended credit decision
- Documentation and analysis necessary to support the credit decision
- See sample Commercial Loan Credit Memo in Handout

Initial Poll



By show of hands
Commercial Lending
Experience

New to Commercial Lending

Only a couple of years experience

5 to 10 years experience

10 to 20 years experience

20+ years experience

Purpose of the Credit Memo

- New loan request
- Renewal of existing loans
- Modification of existing loans
- Risk rating downgrade/upgrade

Purpose of Credit Memos for the Borrower

- Communicate the story of your client to your audience
- Lender's role as intermediary
- Your audience was not present at your meeting with the client
- Balance your role as a loan officer and as an advocate for the client's request

Target audience for Credit Memos

1. Loan Committee/Credit Approvers
2. Executive Management
3. Board of Directors
4. Loan Review/Internal Audit
5. Bank Regulators
6. Loan Documentation Staff

Remember your target audience when preparing credit memos.

Considerations of the Credit Memo - The 5 Cs of Credit

- Character
 - Credit history
- Capacity (Cash Flow)
 - Ability to repay the loan
- Collateral
 - Type of collateral and it's location (if applicable)
- Capital
 - Borrower's down payment (equity into loan request)
- Conditions
 - Terms of the loan request

Coverage of the Credit Memo - The 5 Ws and How

- Who?
 - The borrower and/or guarantors
- What?
 - Purpose of the loan request; terms of the loan
- Where?
 - Location of the collateral and business
- When?
 - The timing of the loan request
- Why/How?
 - How will the loan be used and cash flow timing with the business

Front Page - Summary of Loan Terms & Basic Details

- Borrower's legal name & address
- Ownership structure (LLC, corporation, partnership, etc.)
- Guarantor's name & address
- Years in business
- Loan officer name
- Total Debt – Direct & Indirect with the bank
- Collateral Summary – Type and estimated value
- Loan Risk Rating
- Recommendation
- New or existing customer (customer since – year)
- Exceptions

Specific Loan Request - Basic Details

- Loan purpose
- Background/history of the borrower
- Loan amount
- Payment details (P&I / Interest only / Balloon / Etc.)
- Interest Rate (pricing)
- Maturity Date
- Loan Fees
- Collateral
- Covenants – Financial or documentation (i.e. annual PFS; financial statements, prepayment penalty, etc.)
- Conditions to close (i.e. – Proof of insurance; appraisal; building permit; etc.)
- Policy Exceptions

Goal: Clarify what the borrower wants and why

Relationship overview (Existing customer)

Summarize the current banking relationship

- Deposit accounts (any ODs – Overdrafts?)
- Existing loans and performance (current or past due history)
- Fee Income
- Payment history

Goal: Highlight to overall relationship value

COMMERCIAL LOAN CREDIT MEMO

****This is a fictional company created to provide an example of a commercial credit memo****

Check all that apply:

New
Renewal
Renewal w/ Incr. **X**

Refinance
Modification
TDR

Date: 7/14/26

Borrower: ABC Distribution Corporation
2026 Peachtree St.
Anytown, IL 20260

Risk Rating: 4
Loan Officer: Dan H.
Analyst: Daniela T.

Guarantor: Theresa & Tomas Mannion
5051 Maple St.
Anytown, IL 20260

Amount: \$1,250,000 (Increased from \$500,000)

Purpose: Renewal and increase of revolving line of credit for working capital

Term: 12 months

Rate: Prime + 1%, floating; floor of 6.0%

Amortization: Not applicable

Fees: 0.5%

PrePayment: Not applicable

LOC Usage Analysis / Action Plan: High: \$500,000 Low: \$150,000 Ave: \$450,000
Continue with quarterly borrowing base required; Rest the line at \$0 for 1 month each year

Other Loans:

No	Note #	Short Name Borr (B) or Gua (G)	Loan Type	Original Commitment	Outstanding Principal	Available	Next Loan Pmt Due Date	Maturity	Interest Rate	Next RE Tax Pmt Due	Current Rating
1	1001	ABC RE Holdings, LLC	Mortgage	\$ 1,000,000	\$ 955,000	N/A	7/15/26	7/15/45	7.00%	9/1/2026	4
2	Proposed	ABC Dist. Corp.	Revolver	\$ 1,250,000	\$ 500,000	\$ -	TBD	TBD	7.25%	N/A	4
Totals:					\$ 1,455,000	\$ -					
Total Exposure					\$ 2,205,000						

Repayment Source: Primary – Business cash flow
Secondary – Sale of collateral
Tertiary – Guarantor income

Background on the credit memo

- Background of the borrower
 - How long in business?
 - Type of business?
 - Where is the business located?
 - Key principals/guarantors in the business?
 - Where do they currently bank?
 - How did we obtain this opportunity? “Why are we so lucky?” vs. other competing banks

Goal: Explain who they are and what they do

Business/Industry Review

Describe operations and market conditions

- Core products/services
- Customer base and concentration (generally more than 25% of revenues)
- Key suppliers
- Competition
- Industry trends or risks
- Economic/environmental considerations

Goal: Show the bank understands the borrower's environment

Deposit Relationship:

Account Relationships					
TYPE	ACCT. NO.	2025 AVG. BALANCE	ACCT. TITLE	DAYS OD	DAYS OD PREV.YR.
DDA	1001	\$ 20,260	ABC Dist. Corp.	0	0
MMA	1002	\$ 40,520	ABC Dist. Corp.	0	0
DDA	2001	\$ 15,510	Theresa & Tomas Mannion	0	0
Total:		\$ 76,290			

Background:

Teresa & Tomas Mannion, wife and husband, are 51/49% owners, respectively, of ABC Distribution Corporation and ABC RE Holdings, LLC, which owns the warehouse where they operate their business. They have been clients of the bank since 2019. They have owned the business since 2018 when they started the company. They have 20 years of experience in the electronics distribution industry. ABC Distribution Corporation supplies specific key components to the small and medium sized drone industry. They initially supplied the drone industry in its early life cycle when both recreational and commercial uses were in their infancy. They had developed connections in their prior work experience and invested early on to supply key components for small and medium-sized drones. They were able to operate in smaller rented space and supplied local and regional players in the drone industry. As the industry developed and demand grew, they had sufficient financial resources to be not require outside financing. Then as more people became familiar with how to use drones to save time and resources for both commercial and law enforcement use, demand exploded. In recent years, they needed to expand their space to operate and house their business. In 2025, they needed a business loan to purchase their current warehouse and office space. They created ABC RE Holdings, LLC, to own the business property and lease it back to their company ABC Distribution Corporation. In late 2025, they obtained some of their largest contracts to date from law enforcement and rescue agencies which required them to request a substantial increase to their revolving line of credit as it outstripped their self-funding to date.

Financial Analysis (Part 1)

- Summarize historical and current financial strength
- Historical financials (3 years is typical)
 - Revenue trends
 - Top line revenue growth/decline/stable (Total \$)
 - Revenue growth over prior year; average growth/decline over a given time period
 - Profitability
 - Gross margin; operating margin; net margin
 - As a % of revenues are these increasing/declining/steady
 - Why? No elevator analysis; reader wants to understand why behind the changes
 - Cash flow performance
 - Cash flow (CF) from operations; CF from investing; CF from financing
 - Balance sheet strength
 - Equity capital (% of assets); increasing/decreasing/steady
 - Tangible net worth (excludes intangible assets)

Financial Analysis (Part 2)

- Key Metrics
 - Debt Service Coverage Ratio (DSCR or DSC)
 - EBITDA (or EBITDAR)/PITI (principal, interest, taxes & insurance)
 - Leverage ratios
 - Debt/Equity; Debt/New Worth; Debt/Tangible Net Worth (excludes intangible assets)
 - Liquidity ratios
 - Current ratio
 - Quick ratio
- Interim Financial Statements (if applicable)
 - Depends upon size of credit for your bank
 - Type of loan (C&I more likely than Rental property loan)
 - Refer to your bank's policy

Goal: Demonstrate ability to repay

Elevator Financial Analysis (XYZ LLC)

- Revenue growth and margins
 - Revenues to XYZ LLC increased by 10% in 2024 and 25% in 2025
 - Gross margins declined from 70% in 2024 to 50% in 2025
 - Operating margins declined from 20% in 2024 to 10% in 2025
 - Net margins declined from 10% in 2024 to 3% in 2025
- Activity Ratios
 - A/R days increased from 30 days in 2024 to 55 days in 2025
 - Inventory days increased from 20 days in 2024 to 40 days in 2025
 - A/P days are relatively stable from 20 days in 2024 to 25 days in 2025

Goal: Explain what is happening behind the financial spreads

More Robust Financial Analysis (XYZ LLC)

- Revenue growth and margins
 - Revenues to XYZ LLC increased by 10% in 2024 and 25% in 2025
 - Gross margins declined from 70% in 2024 to 50% in 2025
 - Operating margins declined from 20% in 2024 to 10% in 2025
 - Net margins declined from 10% in 2024 to 3% in 2025

XYZ LLC developed a complementary product line to their core product and did a marketing push to sell to existing clients and expanded into an adjacent region due to perceived demand for their products. This higher investment in expanded sales efforts resulted in lower margins as they work to gain a foothold in the adjacent region.

Goal: Explain what is happening behind the financial spreads

More Robust Financial Analysis (XYZ LLC)

- Activity Ratios

- A/R days increased from 30 days in 2024 to 55 days in 2025
- Inventory days increased from 20 days in 2024 to 40 days in 2025
- A/P days are relatively stable from 20 days in 2024 to 25 days in 2025

Due to XYZ LLC's expanded sales efforts, they produced more inventory and provided more favorable terms to their new clients in the adjacent region and incentivized existing clients with more favorable terms for the complementary product line. This increased the A/R days and inventory days, which resulted in higher revenue growth but resulted in a higher need for working capital.

Goal: Explain what is happening behind the financial spreads

Financial Summary:

Corporate Analysis

In 2025, ABC Distribution Corporation was able to add 4 larger clients that operate in the law enforcement and search & rescue space with their drone components. This contributed to the rapid sales growth as well as their larger clients needing more components due to their drone fleet expansion. This has now resulted in a larger customer concentration with their top two clients accounting for 35% of sales. Most of these contracts have terms of 3 to 5-year supply contracts with municipalities, state and federal government agencies. This has increased their customer risk profile since they are not guaranteed long-term contracts. See the financial results below.

Sales growth analysis:

Revenues increased from \$4,000,000 in 2023 to \$5,000,000 in 2024 to \$7,000,000 in 2025.

- 2024 – 25% revenue growth
 - 2025 – 40% revenue growth
-
- Revenues are growing rapidly due to their success of obtaining governmental contracts as drone use has increased rapidly by various governmental agencies in law enforcement and search & rescue operations.

Income/Expense margin analysis:

Gross Margins declined from 50% in 2023 to 45% in 2024 to 43% in 2025.

Operating Margins declined from 20% in 2023 to 15% in 2024 to 10% in 2025.

Net Margins declined from 12% in 2023 to 9% in 2024 to 5% in 2025.

- Margins have been compressed as the company has bid on larger contracts with smaller margins to expand their future growth opportunities in the with government customers.

Activity ratios:

A/R days increased from 20 days in 2023 to 25 days in 2024 to 55 days in 2025.

Inventory days increased from 15 days in 2023 to 20 days in 2024 to 30 days in 2025.

A/P days are relatively stable at 20 days in 2023 to 25 days in 2024 to 30 days in 2025.

- Due to the rapid sales growth, they provided more flexibility with payment terms as many governmental agencies at all levels (local, state and federal) typically take advantage of sizable contracts to pay slower. This is reflected in higher A/R days. This rise in revenues required a larger investment in inventory as shown by higher inventory days.

Liquidity ratios:

Quick ratio – NM

Current ratio - NM

Leverage ratios:

Debt/TNW (Tangible Net Worth) increased from 1.1x in 2023 to 1.4x in 2024 to 2.3x in 2025.

- The company has been utilizing more debt to help finance faster revenue growth over the past few years as it has outpaced their profitability growth to self-finance.

Guarantor Analysis

The Mannion's net worth is \$1.4MM comprised as follows:

- Bank accounts with \$26,000
- Residence valued at \$1.0MM with \$500,000 mortgage
- Business real estate valued at \$1.5MM with \$955,000 mortgage
- Retirement assets of \$300,000
- Vehicles and personal assets valued at \$100,000 with \$50,000 in vehicle and credit card debt

Personal Financial Statement (000's)							
Borrower(s)	Date of Stmt	Total Assets	Liabilities	Net Worth	Liquid Assets	CSVLI	2025 PTR Total Income
Theresa & Tomas Mannion	5/31/26	\$ 2,926,000	\$ 1,505,000	\$ 1,421,000	\$ 26,000	N/A	\$ 202,600

Repayment Sources

- Primary source of repayment
 - Business cash flow
 - Rental income from the property
 - Sale of the property
- Secondary source of repayment
 - Sale of collateral
 - Rental income from the property (builder unable to sell property)
- Tertiary source of repayment
 - Guarantor income
 - Guarantor collateral
- Sensitivity or stress testing

Goal: Prove repayment is realistic under normal conditions

Repayment Source:	Primary –	Business cash flow
	Secondary –	Sale of collateral
	Tertiary –	Guarantor income

Cash Flow: Business DSC is 1.28x
Global DSC (including personal income & personal debts) is 1.38x

Collateral Analysis

- Collateral evaluation is an important and separate part of the underwriting process/
- With increasing loan amounts and higher complexity of the credit more diligence is required to understanding the loan collateral.
- The credit memo should:
 - Describe the collateral
 - Its location
 - Its value
 - The overall LTV based on bank policy

Goal: Protect the bank if repayment fails

Collateral Considerations (Part 1)

- Locate the collateral
 - Lend to the entity that owns the collateral
- Identify the collateral
 - What type is it? Cash/Securities/A/R & Inventory/Equipment/Vehicles/Real Estate, etc.
- Create the bank's legal claim to the collateral
 - Perfect your lien position (typically 1st lien; sometimes 2nd lien position)
- Sell the collateral for enough to maximize the bank's recovery
 - Bankers are conservative and prepare for the worst case scenarios

Collateral Considerations (Part 2)

- Liquidity
 - How quickly can it be converted to cash?
- Marketability
 - Is it desirable? Is it useful to another business?
- Collateral Value Stability
 - Marketable securities
 - Equipment
 - Real Estate
 - A/R & Inventory
- Control over collateral
 - Can the bank gain control easily or does it take a longer legal process?

Collateral Valuation Methods

- Cost Approach
- Market Approach (Sales Comparison)
- Income Approach
- Orderly Liquidation/Liquidation Approach
 - Used for equipment/machinery/vehicles/inventory (raw, in-process, finished goods)

Collateral:

Collateral Summary						
Description	Date / Source	Value	% Adv	Prior Lien	Lendable Value	Loan Balances
1st mtg Bldg at 2026 Peachtree St.	6/1/25	\$ 1,500,000	75%	\$ -	\$ 1,125,000	\$ 955,000
UCC-1 all biz assets (A/R, Inventory, equipment)	5/31/26	\$ 1,500,000	75%	\$ -	\$ 1,125,000	\$ 1,250,000
Net Equity:						\$ 45,000

Credit Risks and Mitigating Factors (Part 1)

Identify risks and how they are addressed

- Common Risks
 - Customer concentration
 - Cyclical Industry (i.e. homebuilding; automobiles; airlines)
 - High leverage (i.e. homebuilding; airlines; petrochemicals)
 - Weak cash flow
 - Limited collateral

Credit Risks and Mitigating Factors (Part 2)

- Mitigating Factors
 - Strong guarantors
 - Long operating history (successfully navigated various business cycles)
 - Stable contracts
 - Conservative structure
 - Strong current liquidity (or access to liquidity via unused lines of credit or investors)

Goal: Show balanced judgment

Strengths:

- Growing demand within their industry as evidenced by recent rapid revenue growth
- Guarantors over 20 years' experience in the electronics industry along with 8 years in the drone industry
- Good business cash flow with business DSC of 1.28x
- Strong global cash flow with combined DSC of 1.38x
- Good guarantor strength with \$1.4MM net worth tied up mostly in real estate; limited liquidity

Weaknesses:

- Concentration of business with two clients accounting for 35% of total revenue
- Weaker than expected business and personal liquidity
- A/R days is higher at 55 days, which is taking longer to convert sales into cash for their business

Risk Rating Analysis: 4 – Satisfactory credit risk

Recommendation: Loan officer recommends approval based upon the above strengths of this credit request.

Covenants & Conditions

List of key loan conditions

- Financial reporting requirements
 - Frequency of business and personal guarantor financial info (Annual, quarterly)
- Minimum DSCR (or DSC) or liquidity covenants
 - Annual or quarterly measurement of minimum DSCR
 - Minimum current or quick ratio for liquidity covenant
- Borrowing Base requirements
 - Frequency – Monthly, quarterly, per each loan draw request
- Annual review/appraisal updates
 - Annual borrower financial review; possible collateral appraisal updates
- Restrictions on additional debt
 - Most standard loan language limits additional debt to a maximum dollar amount (i.e. \$5,000) without prior bank approval

Goal: Define how the bank will manage risk

Policy

Exceptions: None.

DDA

Required: Yes, primary operating accounts for borrowing entities

Conditions & Covenants:

1. Evidence of sufficient business insurance
2. Satisfactory UCC-1 lien search
3. Rest the new revolver at \$0 for 1 month per year

Monitoring Requirements: Annual business & personal tax returns
Annual business financial statements
Quarterly Borrowing Base Certificate
Quarterly A/R aging & Inventory aging & A/P aging

Recommendation

Conclude with a clear approval request

- Approve/decline recommendation
- Loan structure summary
- Key reasons for approval
- Conditions prior to closing (see examples below)
 - Evidence of insurance on the business and/or collateral
 - Receipt of an appraisal (equipment/inventory/vehicles/real estate)
 - UCC search

Goal: Provide decision ready documentation

Credit Memo Challenges (Part 1)

- Forms & consistent application
 - Standardize the format as much as practicable
 - Provides efficiency for the reviewer/approver
- New underwriting vs. renewals
 - New loans – Loan officer tells the story
 - Renewals – Credit analyst/underwriter
- Time constraints – Who prepares
 - Credit analyst/underwriters
 - Loan officer with credit analyst assistance on financial spreads

Credit Memo Challenges (Part 2)

- Long form / Short form
 - Long form for new clients, larger loan amounts or more complex loan requests
 - Short form for renewals, smaller loan amounts, modifications or risk rating changes
- Narrative or bullet point issues
 - Narrative on executive summary, background, loan request details
 - Bullet points on strengths/weaknesses, financial summary, customer concentration
- Quality Control
 - Consistent approach
 - Need some flexibility for exceptions

Verb tense and usage (Active voice)

See the examples:

Passive voice:

- “Revenues have increased by 10% over the past year”
- “The bank has been lending to our client since 2020”

Active voice:

- “Revenues increased by 10% in 2025”
- “This is our client since 2020”

Goal: Active is more succinct, concise and to the point

Inductive method

- Provide key points to build support for the loan decision recommendation
- Here is an example below:
 - ABC Inc. has 10+ years in business
 - Debt Service Coverage is greater than 1.50x
 - LTV is less than 60%
 - Strong liquidity - more than \$250,000 bank deposits
- Based upon the above information, we recommend approval of this loan request

Deductive method

- Provide the loan decision recommendation then show support with key points
- Here is an example below:
- We recommend approval of this loan request based upon the following:
 - ABC Inc. has 10+ years in business
 - Debt Service Coverage is greater than 1.50x
 - LTV is less than 60%
 - Strong liquidity - more than \$250,000 bank deposits

Summary of Credit Memo sections

1. Executive Summary
2. Borrower Background
3. Loan Request
4. Business/Industry Review
5. Financial Analysis
6. Repayment Sources
7. Collateral Analysis
8. Risks & Mitigants
9. Covenants/Conditions
10. Recommendation

Source: ChatGPT 5.2; Prompt: "Basic information for writing a credit memo"